

KPMG submission

Exposure Draft

*Tax Laws Amendment (Tax Integrity:
GST and Digital Products) Bill 2015*

12 May 2015

13 July 2015

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Executive Summary

Expanding the GST regime to include imported digital products and other services provided by foreign entities is a significant development and will place Australia as an early-adopter in the spirit of the Organisation for Economic Co-operation and Development's (OECD) guidelines for Business to Consumer ("B2C") supplies. KPMG is a strong advocate of the OECD's approach to harmonising the international tax system and so supports the principles behind the government's measure. However, we would like to provide comment about three aspects of the Exposure Draft (ED):

Broad application. The ED leaves unanswered questions about how these new measures will interact with some existing, and potentially future, GST provisions. This includes, but is not limited to, various GST-free provisions, telecommunications supplies, gambling, insurance provisions and financial supplies.

As this arises from the broad drafting of the ED, there are two alternative options to address this 1) to undertake a comprehensive tracing of all of the consequential amendments required to ensure certainty, or 2) draft the provisions more narrowly to target the perceived mischief.

Reporting. To encourage voluntary compliance by non-residents it is desirable that the Australian system be harmonised with commercial global data and reporting requirements to the greatest extent possible, rather than relying on, for example, tax residency status as a question of Australian tax law.

There is a strong case to align the requirements for determining where such supplies are consumed with those used in other VAT jurisdictions, such as the European Union, by adopting a "location of consumer" principle, as opposed to looking at the Australian tax residency status of the consumer.

Registration. The ability to prescribe further administrative rules is identified in the ED. Detail surrounding such administrative rules will be critical to the effective operation of this new regime and, in many cases, will be as important as the legislation itself.

Therefore key practical issues about the consequential details of the registration system should be considered and consulted on prior to the passing of the legislation.

Detailed comments

1.0 General

- 1.1 KPMG welcomes the opportunity to comment on the ED of *Tax Laws Amendment (Tax Integrity: GST and Digital Products) Bill 2015* and associated Explanatory Memorandum (EM) as published by Treasury on 12 May 2015.
- 1.2 This issue, referred to in the media as the so-called ‘Netflix tax’, has been the cause of considerable public and business interest. Expanding the GST regime to include imported digital products and other services provided to Australians by foreign entities is a significant development and will place Australia as an early-adopter of the OECD’s guidelines for B2C supplies.
- 1.3 KPMG is a strong advocate of the OECD’s approach to harmonising the international tax system and so supports the policy and principles behind the government’s measure. KPMG has provided input into submissions made by other professional bodies which have identified a number of areas for consideration. The focus of this particular submission is on concerns or questions raised by our overseas clients potentially impacted by the proposed changes. There is a strong willingness to comply, however to do so, non-resident suppliers require not only certainty but their Australian tax obligations need to be able to be readily understood as this will be crucial to the effectiveness of this measure.

2. Broad application

- 2.1 As drafted the proposed changes require an interaction with numerous sections of the current GST law for example various GST-free provisions, input taxed provisions and other special rules. Such drafting requires an extensive and comprehensive tracing (and in many cases deeming) to give effect to the intent of the changes. In adopting such an approach there is a risk of omitting key aspects of the drafting to achieve this.
- 2.2 The proposed legislation is an integrity measure targeted at foreign entities, many of whom are not familiar with the Australian GST regime. While at first glance the ED looks simple, the current drafting results in both uncertainly and unnecessary complexity being built into the system.

2.3 As such, we recommend further work to ensure the proposed changes will give effect to the intended outcome in all cases. We consider there are two alternative options to ensure the intended outcome is achieved:

- 1) undertake a comprehensive tracing of all of the consequential amendments required to ensure certainty; or
- 2) draft the provisions more narrowly to target the perceived mischief only.

3. Unintended outcomes from interaction with other sections of the GST Act

3.1 If broad drafting utilising the “connected with the indirect tax zone” rules in section 9-25 with appropriate carve outs, is preferred over a more narrowly drafted specific provision, then a comprehensive level of detailed tracing and consequential amendments will be necessary.

3.2 The ED in its current form has not addressed all of those consequential amendments to provide clarity and certainty about how these new measures will interact with existing, and potentially future, GST legislation. This includes telecommunications supplies, insurance provisions GST-free medical, financial supplies, gaming supplies, Government taxes fees and charges. We provide some illustrations below.

3.3 GST-free provisions under Division 38

The current measures seek to rely on the GST-free provisions where supplies are made to Australian residents, but are not necessarily consumed within Australia. Our observation with the GST-free provisions, in particular section 38-190, is that the provisions are already complicated and require significant interpretation to ensure compliance. They were designed to apply to outbound supplies but in the present context are required for inbound imported intangible supplies. These provisions are already the subject of six Australian Taxation Office Goods and Services Tax Rulings, totalling 546 pages.

3.4 Financial supplies under Division 40

It is not clear how the current measures will interact with the current financial supply provisions, in particular, in relation to offshore bank accounts.

3.5 *Insurance provisions under Division 78*

Arguably the proposed measures will apply to supplies of insurance by non-residents. It is not clear whether this was an intended consequence of the proposed legislation, and how this will be applied in the various insurance scenarios that may arise, such as where there is a non-resident underwriter with an Australian insurance company and Australia individual cedent.

3.6 *Government taxes, fees and charges under Division 81*

Currently, GST does not apply to the payment of taxes, fees and charges by a government where certain requirements under Division 81 are satisfied. Under the new proposed measures, there is uncertainty as to whether taxes, fees and charges made by a government other than the Australian government, that are charged to an Australian resident, are potentially caught.

3.7 *Telecommunication supplies under Division 85*

Broadly, under the current GST Act, telecommunication supplies made by non-resident providers that are effectively used or enjoyed in Australia are included in the GST system. However, in line with the legislation the Commissioner has made a Legislative Determination stating that, in certain circumstances, he will not collect the GST revenue on these supplies. The policy rationale for this section is that where a non-resident telecommunications supplier is not registered for GST purposes, it is administratively difficult to collect the GST on telecommunication supplies made in Australia. However, the new proposed measures appear to work in direct contradiction to this rationale.

3.8 It would be useful to clarify the interaction between the proposed measures with these sections of the GST Act to reduce uncertainty in these areas and include further examples in the EM that consider the interaction between the proposed measures and these sections. Further comprehensive tracing of the consequential amendments would then ideally be required to ensure certainty.

4. Previously announced GST cross-border changes

4.1 By way of background, on 14 December 2013, the Assistant Treasurer announced that the government intends to proceed with a previously announced measure to

amend the “connected with Australia” rules. The measure was initially announced in the 2010/11 Federal Budget following the Board of Taxation’s *Review of the application of GST to cross-border transactions*, and was intended to simplify the GST cross-border rules and reduce the number of non-residents who were unnecessarily drawn into Australia’s GST system.

- 4.2 We strongly recommend consideration is given to incorporating these proposed measures within the previously announced Board of Taxation’s cross border changes to avoid unnecessary drafting complexity, and to ensure they are consistent outcomes with future cross-border changes in the GST law.
- 4.3 If such changes are made to the GST law after the introduction of the current proposed changes the drafting of the GST law will be complex and there is a risk that with such complex drafting arises unintended outcomes.

5. Narrowing the application of the ED

- 5.1 As already outlined, one alternative option would be to draft the provisions narrowly to target the perceived mischief, which would reduce the level of comprehensive tracing and consequential amendments required.

6. Data and reporting requirements

- 6.1 In our experience, the Commissioner is now increasingly focused on the integrity of reporting systems to accurately determine GST obligations, particularly for large businesses, such as multinationals. Under the current proposed measures, the key determining factors of whether a supply of a thing other than real property and goods will be:
 - the Australian tax residency status of the recipient, and
 - that recipient’s GST registration status – ‘registered or required to be registered’.
- 6.2 We consider that the ED should utilise data already collected from customers wherever possible. In effect, harmonise global data and reporting requirements to the greatest extent possible, rather than relying on tax residency status which is question of Australian taxation law and does not apply to all GST entities (for example, trusts,

which may add an extra layer of complexity). Our concerns in relation to the above are outlined below.

6.3 *Tax residency status requirement*

We make the following observations in relation to the ‘residency status’ requirement:

- Businesses currently do not collect information about a recipient’s tax residency, which is a question of Australian law to be determined by principles in the *Income Tax Assessment Act 1936*.
- Tax residency status also cannot be easily determined by foreign suppliers who in many cases undertake high volume, low value transactions, where lengthy contracts are not entered into, and occur through website interfaces.

6.4 Our view is that the characteristics of a recipient’s status are not easily identifiable for a large business supplier. Rather, information as to the ‘location of the consumer’ such as billing address, VPN or credit card details is more readily available to a supplier during the course of carrying out a transaction.

6.5 In light of these practical difficulties, we consider there is merit in aligning the requirements for determining where such supplies are consumed with those used in other Value Added Tax jurisdictions, such as the European Union, which looks at the “location of the consumer” through considering the location of the ISP or VPN being used by the recipient and/or their billing address.

6.6 Furthermore, multinationals in those foreign jurisdictions have developed systems capable of collecting the information, and Australian may be able to leverage these systems to allow rapid compliance with the Australian legislation.

6.7 *GST registration status requirement*

In relation to the requirement that the recipient be “not registered or required to be registered” for GST, we observe the following that

- The GST registration status is available publicly through the ABR website, but whether a recipient is ‘required to be registered’ (but is not GST-registered) is not publicly available through the ABR website and is determined on an individual basis.

- Again, the GST registered (or ‘required to be registered’) status is also not something a supplier can readily identify during high volume, low value transactions, nor whether the acquisition is made in the course of the registered recipient’s enterprise.

6.8 *Other observations*

We observe that there are practical issues with obtaining the above information, which are identified as follows:

- Obtaining the relevant information will most likely need to be built into website interfaces or marketplace operator systems, and suppliers will then rely on the honesty of the recipient when responding to the questions. They should not be penalised in such cases.
- Where multinationals’ web pages are used in multiple jurisdictions, Australian recipients will need to be directed to interfaces designed specifically for Australian residents to ensure this information is collected.

7. Registration

7.1 We acknowledge that the registration system for reporting and paying obligations under these proposed measures is yet to be determined. However, consequential detail that our clients have raised concerns about include the following in relation to the registration system:

- If an entity registers under the simplified approach, which does not allow for claiming input tax credits, consider allowing further flexibility such that an entity later join the current registration regime to allow for claiming of input tax credits at a later date;
- Likewise, consider implementing transitional arrangements where a non-resident who is currently registered can move to the simplified approach once it has been introduced;
- Include examples in the EM that clarify the implications of changing the registration threshold for supplies under the proposed measures, such that there are two registration thresholds. For example, where a supply is connected with Australia under the current measures, but the supplier is under the threshold,

and also connected under the proposed measures – in this circumstance, a separate threshold may now apply and it still may be taxable;

- Clarify whether the simplified GST registration measures only apply to supplies under the proposed measures, or whether a non-resident making supplies that are connected under the current rules register can pay under the simplified measures.

It would be useful if Treasury could consider these final details prior to finalising registration system under the proposed measures to minimise any practical difficulties with its implementation.

8. Miscellaneous

- 8.1 On a final note, we make an observation as to whether Division 84 is the appropriate place for the electronic platform modifications. To avoid potential confusion, you may consider including these provisions in separate and stand-alone division of the GST Act.

We would welcome the opportunity to discuss and elaborate on the points highlighted above.